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CHARLES ELMORE CROPLEY

In the Supreme Court of the United States

OCTOBER TERM, 1949.

No. 533

THE LINCOLN ELECTRIC COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Sixth Circuit, and BRIEF IN SUPPORT.

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January 3, 1950.

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the Sixth Circuit to review the judgment entered August 29, 1949, in cause No. 10,728 on its docket, entitled *Commissioner of Internal Revenue, Petitioner, v. The Lincoln Electric Company, Respondent,* wherein the court, one judge dissenting, reversed the decision of the Tax Court.

MATTER INVOLVED.

This is a tax case.

It involves the labor-management incentive system of The Lincoln Electric Company. The company, located in Cleveland, Ohio, is engaged in the manufacture of electric arc welding machines, electrodes and supplies.

The case has been twice in the Court of Appeals.[1]

[1] Volumes I, II and III of the record constitute the record upon the first review by the Court of Appeals. They were by stipulation made part of the record upon the second review now here (R. Vol. IV, p. 118). Volume IV contains the proceedings in the Court of Appeals upon the first review, the further proceedings in the Tax Court upon the remand, and the subsequent proceedings in the Court of Appeals upon the second review, to which this petition for writ of certiorari is directed.

The case turns on Internal Revenue Code § 23(a)(1)-(A). This statute for 30 years has provided, as it does now, that, in computing income subject to tax, deduction "shall be allowed" for:

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *."

The payments in question are premiums paid in 1941 upon an employees' group retirement annuity policy (R. Vol. III, p. 637) and to an employees' trust (R. Vol. III, p. 680). The annuity policy, issued by Sun Life Assurance Company of Canada, was taken out by the taxpayer in 1936 upon the suggestion of the Employees' Advisory Board. The Board, organized in 1914, consists of 26 members of which 22 are workers in the plant. The policy covers every person in the company's employ. The entire cost is paid by the taxpayer. The trust, likewise instituted at the suggestion of the Employees' Advisory Board, covers every employee except salesmen, the president, and the chairman of the board. No part of the money paid upon the annuity and the trust can be repaid to the company. (R. Vol. IV, pp. 108-11.) For these purposes the company paid the following sums (R. Vol. I, p. 23):

Year	Annuity	Trust
1936	$ 486,389	
1937	359,804	
1938	99,931	
1939	132,252	
1940	400,009	
1941	575,206	$1,000,000
Total	$2,053,591	$1,000,000

The payments in 1936, 1937, 1938 and 1939 were allowed by the Commissioner. The payments for both 1940 and 1941 were initially challenged in this case, but, after

the decision of the Court of Appeals upon the first review, the 1940 payment was allowed. The 1941 payments alone remain in question.[2]

The taxpayer claimed these payments alternatively as:

"(1) compensation paid for personal services actually rendered; or

(2) ordinary and necessary expenses paid in carrying on a trade or business; or

(3) an item of the cost of goods sold"[3] (R. Vol. IV, p. 122).

The Tax Court, over the dissent of Judges Van Fossan, Smith and Black, denied the claim on all grounds (R. Vol. I, p. 20). The Commissioner had raised also an alternative issue that, if the 1941 payments should be held to be compensation, then, in part, they would be unreasonable in amount, but only in the case of 438 employees (all but 34 of them factory hands) out of a total of 979 (R. Vol. III, pp. 612, 613, 620-35; Vol. II, pp. 87-8; Vol. I, pp. 34, 43). This would have resulted in disallowance of $1,055,547 out of the $1,575,206 paid on the annuity and trust in 1941. It would have allowed $519,659 (R. Vol. III, pp. 612, 613, 635).

The Tax Court, however, having denied the payments on all grounds, found it unnecessary to pass on the alternative issue. The Tax Court held:

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[2] The Court of Appeals noted: "The record provides no clue as to why the Commissioner allowed deductions for annuity premiums from 1934 to 1939 as ordinary expenses or reasonable compensation, yet declined to do so in 1940 and 1941 though the earlier contributions were comparable in amount. * * * We understand, of course, that the Commissioner may not be constrained to constancy by any rule of estoppel, but reason and logic might have been expected to justify so complete a change of front." (R. Vol. IV, p. 117.)

[3] If the payments constituted part of the cost of goods sold, then they would be taken into account in computing gross income under Internal Revenue Code § 22 and Reg. 103, § 19.22(a)-5, thereunder, which says that "In the case of a manufacturing * * * business, 'gross income' means the total sales, less the cost of goods sold * * *." In that case § 23(a), which provides for deductions from gross income, would not come into operation.

"In view of our conclusion that the disbursements in dispute did not constitute compensation paid for services rendered, any question of their reasonableness becomes moot" (R. Vol. I, p. 43).

The Court of Appeals unanimously reversed, Judges Simons, Hicks and Allen sitting (R. Vol. IV, p. 107).

The Court of Appeals pointed out that the payments in question were part of the taxpayer's incentive system whereby, in the eight-year period ending in 1941:

"the productivity of the individual employee, measured in terms of units produced, *increased more than threefold,*

the hours of direct labor required to manufacture a given unit was *cut in half,*

the selling price of its product was reduced by nearly *one-half,*

the dividends per share of stock were more than *tripled* and

the earned surplus and undivided profits *doubled*" (R. Vol. IV, p. 109).[4]

The court noted:

"the taxpayer's incentive system, including its high piecework rate, the bonus, the annuity plan and the trust fund were responsible for these results, through a high degree of labor-management cooperation" (R. Vol. IV, p. 109).

The result of this policy, in terms of savings to the American people—the company's customers—is illustrated in the graphs commencing on the opposite page. Prices have been steadily reduced. The significance of this is emphasized when it is noted, as shown on the graphs, what has happened in the same period to the prices of products of industry generally.

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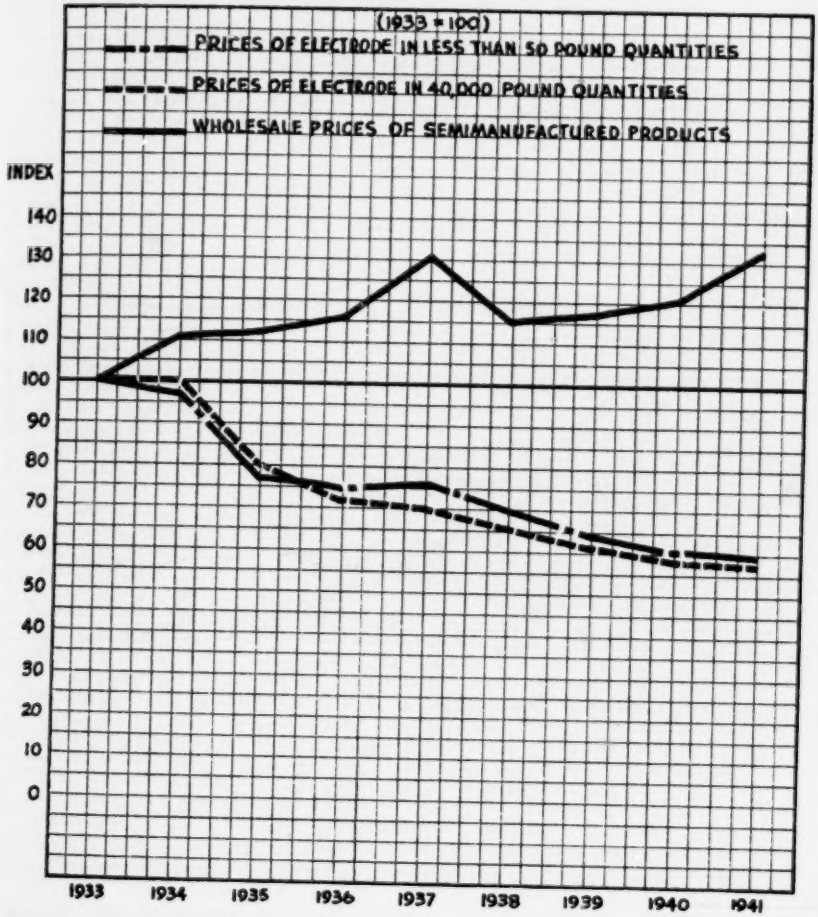
[4] Emphasis supplied throughout.

EXHIBIT 62, R. Vol. III, p. 789.

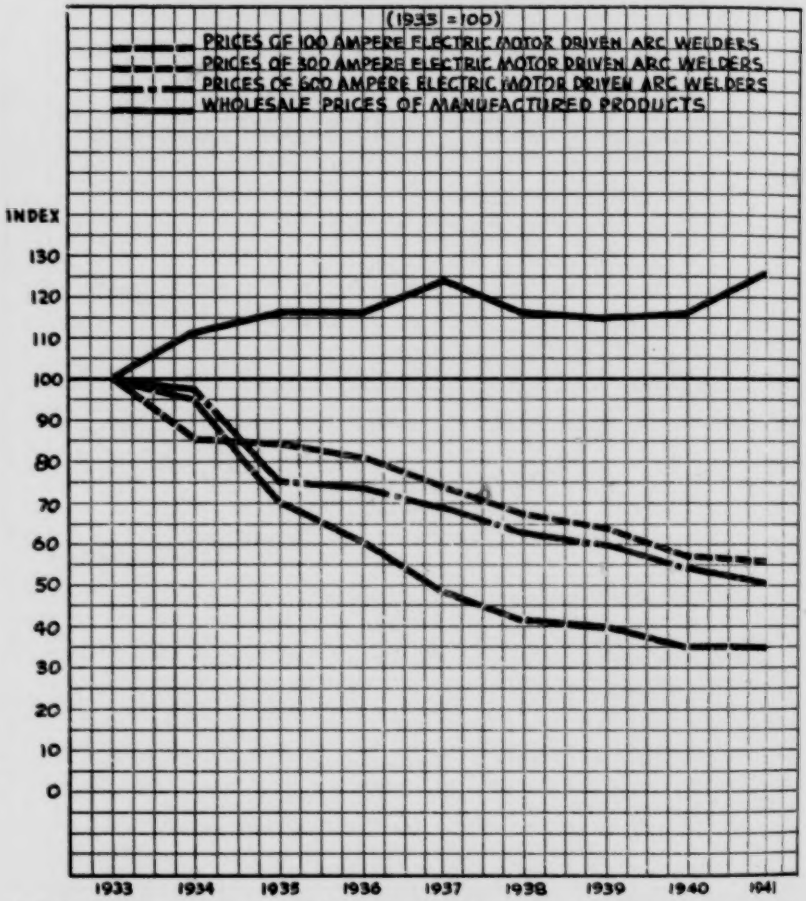
Lincoln Electrode Selling Prices Compared with Wholesale Prices of Semi-Manufactured Products.



Although wholesale prices of semi-manufactured products in the United States rose, as shown by the top line, the company, in the same period, was able to reduce the selling prices of its semi-manufactured products—electrodes—as shown by the two lower lines.

EXHIBIT 63, R. Vol. III, p. 791.

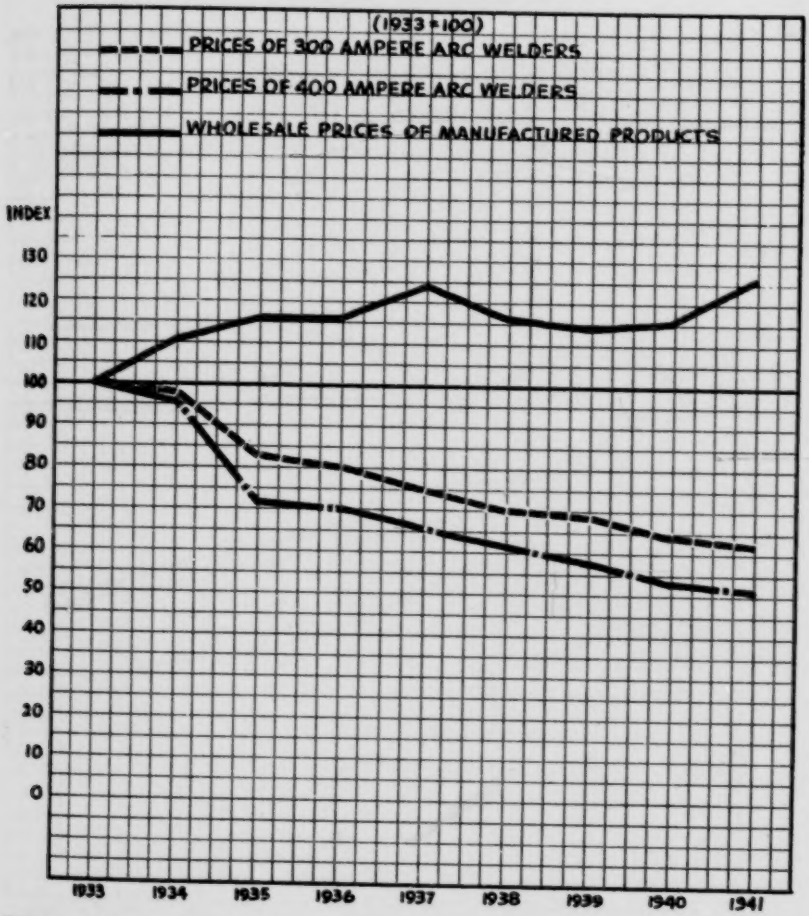
Lincoln Motor-Driven Welder Prices Compared with Wholesale Prices of Manufactured Products.



While wholesale prices of manufactured products in the United States increased, as shown by the top line, the company, in the same period, found it possible to reduce the selling prices of its manufactured products—i.e., electric motor-driven welders—as shown by the three bottom lines.

EXHIBIT 64, R. Vol. III, p. 793.

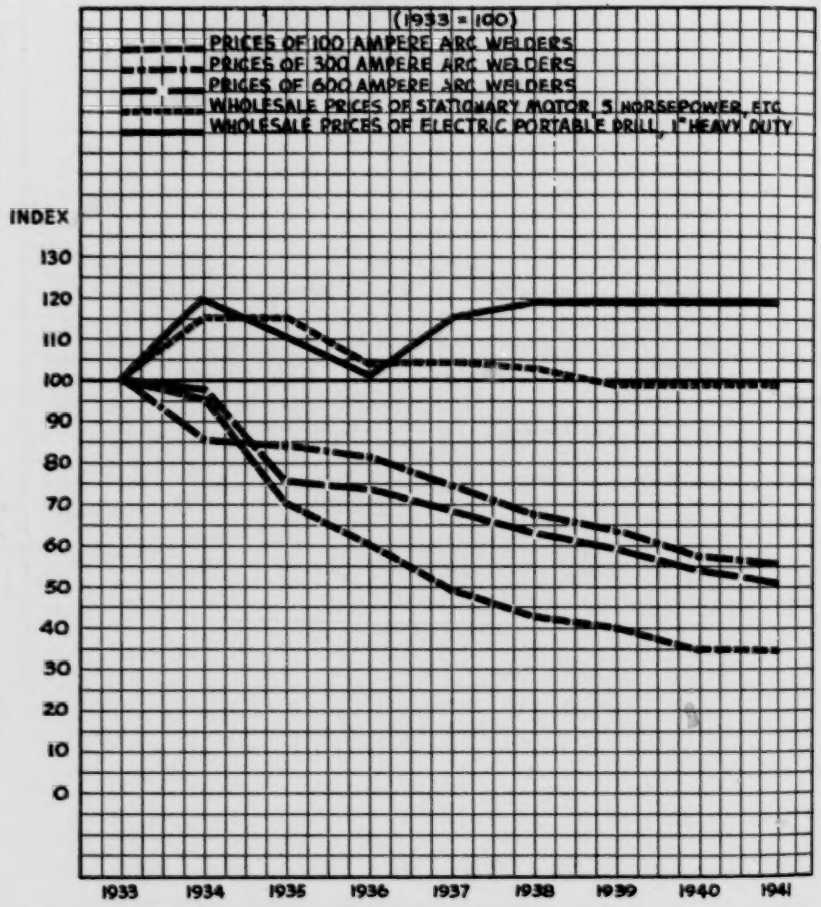
Lincoln Gasoline Engine-Driven Welder Prices Compared with Wholesale Prices of Manufactured Products.



While wholesale prices of manufactured products followed the pattern shown by the upper line, the company was able, in the same period, to reduce the prices of its manufactured products—in this case gasoline-driven welders—as shown by the two lower lines.

EXHIBIT 65, R. Vol. III, p. 795.

Lincoln Motor-Driven Welder Prices Compared with Average Annual Wholesale Prices of Specified Types of Electrical Machinery.



The price behavior of electrical machinery, electric motors and an electric drill, is shown by the two upper lines; price reductions on the company's electric motor-driven welders are shown by the three bottom lines. A welding machine is in substance an electric motor, to supply the power, joined to another having its windings modified to produce the current required for welding, with additional appliances and attachments.

What this policy has meant to the company and its shareholders in increased earnings—and to the United States in increased taxes—is reflected in the following table (Ex. 20, R. Vol. III, p. 727):

Year	Net Income		Dividends Paid per Share[5]
	Before Taxes	After Taxes	
1934	$1,636,543	$1,411,543	$2.50
1935	1,904,649	1,641,649	5.50
1936	2,414,050	1,949,050	6.00
1937	2,944,683	2,336,183	6.00
1938	1,604,525	1,334,525	5.00
1939	2,459,974	2,019,974	6.00
1940	3,239,755	2,189,755	6.50
1941	5,720,919	2,865,919	8.00

The company has prospered (R. Vol. II, pp. 104-12). Its growth has been on the following order (R. Vol. I, p. 22):

Year	Assets	Capital Stock	Paid-in Surplus	Earned Surplus and Undivided Profits
1936	$ 6,686,219	$224,190	$ 620,647	$3,351,927
1937	8,195,281	227,722	859,275	4,477,074
1938	8,055,249	230,246	1,033,431	4,659,151
1939	9,884,225	232,104	1,161,633	5,309,703
1940	11,045,426	234,226	1,308,051	6,017,085
1941	12,657,342	234,226	1,308,051	7,041,123

Of this the Court of Appeals took note. Speaking of the incentive system which brought these things to pass, the court pointed out:

> "there was more than a strain of constancy in the plan. It was first in a small way projected as early as 1918, more fully developed in 1934, liberalized in succeeding years and added to greatly in 1941. It was pursued during an era when mass production methods were developing at incredible speed, when the best engineering brains in industry were dedicated to improvement

[5] The number of shares outstanding during this period remained substantially the same (R. Vol. I, p. 22; Vol. II, pp. 109-10).

in tools and machines and when labor was becoming conscious of some claim to the results of labor-saving devices and increasingly vocal in demand for greater remuneration and shorter hours. It was a period of labor unrest and the petitioner was not alone in seeking means to inspire in its labor force that spirit of loyalty, efficiency and cooperation that should avoid labor strife. The Tax Court pays tribute to the success of the effort. In the words of the *Welch* case [290 U. S. 111], 'payments for such a purpose are the common and accepted means of offense against attack.'" (R. Vol. IV, p. 115.)

The court noted further:

"These measures were pursued in an era when there was increasing development among workers, of a group consciousness manifested in the rapid growth of industrial unions, their demand for collective bargaining and increasingly individual sacrifice to the inviolability of the picket line. Advantage to the group had become more important than individual advantage. Moreover, as industrial units grew large the greater became the injury that might flow from labor strife, and the greater the incentive of forward looking management to seek means to avoid it. In the light of the concept of ordinary expense developed in the *Welch* case, even though not applicable to the facts there disclosed, we are unable to say that the petitioner's outlay for employee benefit, considering its purpose and the clearly demonstrated effectuation of that purpose through a course of years, was not an ordinary expenditure within the meaning of the statute." (R. Vol. IV, p. 116.)

Accordingly, the Court of Appeals held the payments constituted "ordinary and necessary expenses" within the meaning of this statute (R. Vol. IV, pp. 113-6). It refused to hold the payments constituted "compensation for personal services" (R. Vol. IV, p. 117).

The Commissioner did not seek review. The judgment of the Court of Appeals became final. All that remained was to compute the tax.

Upon return of the case to the Tax Court, the Commissioner—in face of the reviewing court's refusal to hold the payments constituted compensation—asked the Tax Court "to pass upon the question of the reasonableness of the payments *as compensation*" (R. Vol. IV, pp. 7, 13, 17, 22, 47). The motion was to "decide the question of the reasonableness of the claimed deductions" (R. Vol. IV, p. 8). This ruling was sought "for reasons more particularly set forth in a memorandum brief hereto attached and made a part hereof" (R. Vol. IV, p. 8). The ground assigned was that the reviewing court:

> "has not laid at rest the question of the reasonableness of the amount of the deduction claimed, **if it is in the nature of compensation.** The question which must be decided, therefore, is whether the court regarded the payments as in the nature of compensation *or deemed them allowable as expenses of some class other than compensation*" (R. Vol. IV, p. 13).

Accordingly, the Tax Court understood that it was asked "to pass upon the question of the reasonableness of the payments *as compensation*" (R. Vol. IV, p. 47).

It is important to note that the Commissioner did not ask the court to rule on the reasonableness of the payments treated as "ordinary and necessary expenses." That issue never had been raised in this case. The Commissioner never had attacked the payments on that ground (R. Vol. III, pp. 612, 613; Vol. II, pp. 87-8; Vol. I, p. 34; Vol. IV, pp. 10, 131-5). Instead, the Tax Court was asked to pass on the amount only *"if it is in the nature of compensation"* (R. Vol. IV, pp. 13, 7-43).

The Tax Court, Judge Leech sitting, refused (R. Vol. IV, pp. 47, 49). The reviewing court had not allowed the payments "as compensation." It had refused so to hold. Said the Tax Court:

> "It is accordingly our view that we are without jurisdiction, under the opinion and mandate of the Circuit Court, to consider further any question as to the

reasonableness of the contested payments *as compensation*" (R. Vol. IV, p. 49).

The Commissioner thereupon sought review in the Court of Appeals.

On the second review, now here, the Court of Appeals, Judge Miller having replaced Judge Simons, and sitting with Judges Hicks and Allen, adhered to the holding that the payments are "ordinary and necessary expenses" (R. Vol. IV, p. 124). The court rejected the Commissioner's argument that the payments were, or were held to be, compensation. It said:

> "We * * * reject the Commissioner's * * * contention that although we classified the payments as ordinary and necessary expenses they were also compensatory in nature and so limited to a reasonable amount" (R. Vol. IV, p. 124).

Thus, the court rejected the sole basis of the motion. But the court reversed the Tax Court.

Judge Allen dissented.

The majority ruled "The motion of the petitioner [i.e., the Commissioner] should have been sustained" (R. Vol. IV, p. 126).

The majority reached this conclusion by holding that the provision for

> "a reasonable allowance,"

which the statute confines to "salaries or other compensation," applies also to payments held to be "ordinary and necessary expenses" of a business.

The result is that, even though the payments *are* "ordinary and necessary expenses"—as the Court of Appeals now twice has held—and even though the statute in mandatory language says "All" such expenses "*shall be allowed*," the taxpayer can claim them only to the extent that in the Commissioner's opinion allowance thereof is "reasonable." The Commissioner thus is made a super-

manager for the nation's business. To him—which means in practical operation the numerous agents of revenue abroad in the land—is given the power to say which, and how much, if any, of the "ordinary and necessary expenses" of carrying on a trade or business shall be allowed.

If this be law, then a great change will have been worked in a vital statute, the meaning of which has been settled for years. This will have been done by (1) rewriting the statute, (2) overturning the settled rule designed to leave in repose conclusions once embodied in a final judgment, and (3) convicting the Tax Court of error in a ruling it neither made nor was asked to make. Thus, there has been introduced into this case a new issue, and into the law a new principle.

JURISDICTION.

This Court has jurisdiction to review the judgment in question upon writ of certiorari, under §§ 1254(1) and 2101(c) of the Federal Judicial Code. 28 U. S. C. §§ 1254-(1), 2101(c).

The judgment was entered August 29, 1949 (R. Vol. IV, p. 119). Petition for rehearing (R. Vol. IV, p. 131), duly filed, was overruled without opinion on October 12, 1949 (R. Vol. IV, p. 143).

QUESTIONS PRESENTED.

The questions presented are:

1. Whether payments, held not to be compensation but instead adjudged to be "ordinary and necessary expenses" of carrying on a business within the meaning of Internal Revenue Code § 23(a)(1)(A), are subject to the further test of "a reasonable allowance" which the statute in terms confines to "compensation for personal services actually rendered."

2. Whether a final judgment entered by a court of appeals, of which no review was sought, may be reexamined in any subsequent proceeding in the same case.

3. Whether the Tax Court may be convicted of error for a ruling it neither made nor was asked to make.

REASONS RELIED ON FOR ALLOWANCE OF WRIT OF CERTIORARI.

The reasons relied on for allowance of the writ prayed for are:

1. The case raises an important question of construction of the revenue law which has not been, but should be, settled by this Court. The statute, Internal Revenue Code § 23(a)(1)(A), applies to every business filing a tax return. It says that in computing income subject to tax "there shall be" allowed as deductions "*All* the ordinary and necessary expenses" of carrying on business.

This provision initially came into the law in 1913.[6] It was in the first income tax law passed following adoption of the Sixteenth Amendment.

The Court of Appeals has amended this statute.

It has declared a principle heretofore unknown.

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[6] The 1913 Act authorized the taxpayer to deduct:

> "all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business" (Act of October 3, 1913, ch. 16, 38 Stat. 114, 172, § IIG (b)).

In the Revenue Act of 1918 Congress added the provision for "a reasonable allowance for salaries." The statute, as then amended, authorized deduction, as it does today, of:

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered" (Act of February 24, 1919, ch. 18, 40 Stat. 1057, 1077, § 234(a)(1); this continues in effect as present Internal Revenue Code § 23(a)(1)(A)).

It has held, reversing the Tax Court, that payments the court twice has held to be "ordinary and necessary expenses"—and which it refused to hold constituted compensation—are subject to further test to determine what is "a reasonable allowance" therefor. The statute confines that test to the "allowance" the statute directs to be made for "salaries or other compensation for personal services actually rendered."

In so holding the court has put in disorder the law concerning "ordinary and necessary expenses," to which every business in the land is subject, and which since 1913 has had the settled meaning that expenses, established to be "ordinary and necessary expenses" must be allowed because the statute, without equivocation, says they "shall be allowed."

Heretofore it has been in the Commissioner's power to determine whether a claimed deduction is in fact an "ordinary and necessary" expense of carrying on the taxpayer's business, or whether it is something else traveling in borrowed garb. To this the court below now has added the further power to say how much of that expense, conceded to be an "ordinary and necessary" expense, shall be allowed. If the Commissioner may disallow part, because he thinks it more than the taxpayer *should* have paid, then he can disallow all. Thus the congressional command that "*All*" such expenses "shall be allowed" is repealed.

This has two consequences of far-reaching importance.

First. It works, without congressional approval, an enormous expansion in the Commissioner's powers. It bestows upon the Commissioner, and his agents throughout the land, a control over the internal management of business affairs which Congress has seen fit to withhold. Had Congress intended to subject to the Commissioner's opinion the amount it is "reasonable" to allow for expenses adjudged to be "ordinary and necessary expenses" of a business, it would have said so.

Second. The decision, without change in the statute by Congress, alters the system of income taxation in this country. It transforms a system designed to impose a tax on income, as authorized by the Sixteenth Amendment, to one imposing a tax upon a fictitious computation which differs from gross receipts only as the Commissioner may determine that a given payment, conceded to be part of the "ordinary and necessary expenses" of a business, is or is not in his opinion reasonable. Such power Congress has not conferred upon the Commissioner. Before it is sealed this Court should examine the right of the claim.

As Circuit Judge Allen, dissenting, noted:

> "This conclusion [of the majority] reads into the statute a limitation which in my judgment does not exist there" (R. Vol. IV, p. 127).

The decision, moreover, threatens with extinction, and certainly with penalties, a system of employee-management relations which, many think, offers the only solution to industrial turmoil, and to which industry, more and more, is turning. Certainly any system which can bring about threefold increase in output, as this has, deserves better than to be strangled by distorted construction of a Revenue Act.

2. The decision below is in conflict with the decisions of this Court relating to the finality of judgments. The Court of Appeals, long after term and long after expiration of time for review, has reopened, and added qualification to, a prior final judgment of which no review or other correction was sought. On the first review the court held the payments in question constituted "ordinary and necessary expenses." Nothing remained but to compute the tax. The judicial process was complete. The Commissioner sought no review. Accordingly when term and time for review passed, that judgment remained "binding upon the Circuit Court and every other court to which the case could

by any possibility be taken." *Metropolitan Water Company v. Kaw Valley Drainage District* (1912), 223 U. S. 519, 523, 524. If any modification of it were possible, "it could be done only by amendment of the mandate. But no move to do this was made during the term at which it went down." *Briggs v. Pennsylvania Railroad Co.* (1948), 334 U. S. 304, 305, 306. As Circuit Judge Allen, dissenting, observed:

> "The judgment of the court in effect grants a rehearing of a case in which final judgment has been rendered and from which no review proceedings were prosecuted" (R. Vol. IV, p. 127).

3. The court below has departed from the accepted and usual course of judicial proceedings, with disturbing consequences to any orderly process for settlement of controversy. Under the decision the Tax Court is now required either:

(a) to pass on the payments "as compensation," for it was the Tax Court's refusal to pass on the payments "as compensation" which has been reversed, or

(b) to decide how much it is reasonable to allow for expenses twice adjudicated to be "ordinary and necessary expenses" of this taxpayer's business, "All" of which the statute says "shall be allowed."

If the former, then the Tax Court in dealing with the payments "as compensation" must proceed in face of the opinion of the Court of Appeals rejecting the Commissioner's contention that the payments were "compensatory in nature and so limited to a reasonable amount" (R. Vol. IV, p. 124). If this case, now seven years in litigation, has settled anything, it is that the payments are *not* compensation. The taxpayer urged that the payments (if not allowable as ordinary and necessary expenses or as part of the

cost of goods sold) constituted "compensation." The reviewing court refused so to hold. But it did hold they were "ordinary and necessary expenses." Thereupon the Commissioner, who on the first review had argued that the payments were not compensation, argued upon the second review that they *were* compensation. This contention the Court of Appeals also rejected. Both parties thus have been told the payments are not compensation. But the Tax Court nevertheless is reversed. Manifestly, if the decision of the Court of Appeals requires—as it appears to do because the ruling is "The motion of the petitioner [i.e., the Commissioner's motion calling upon the Tax Court to pass on the payments "as compensation"] should have been sustained" (R. Vol. IV, p. 126)—then the Tax Court has been reversed for a ruling the Court of Appeals says was right.

On the other hand, if the Tax Court now is to determine what would be a reasonable allowance for expenses twice adjudicated to be "ordinary and necessary expenses" of this taxpayer's business—"All" of which the statute says "shall be allowed"—then the Tax Court has been reversed for a ruling it did not make, upon an issue it was not asked to pass upon, which never was raised in the case, and which was not open under the pleadings. The Court of Appeals has introduced a new issue into the case. It has issued a new statutory notice of deficiency. Not even the Commissioner could do this, his power having been exhausted with the first.

In short, the reviewing court either (a) has reversed the Tax Court for abiding by the reviewing court's opinion, or (b) has convicted the Tax Court of error for a ruling never made upon a motion never presented. In either case the court below has so far departed from the accepted and usual course of judicial proceedings as to make it proper for this Court to examine what has been done.

CONCLUSION.

The writ should issue (1) to settle the meaning of an important statute which the decision below has thrown into confusion with disturbing results to the fabric of the law, (2) to enforce the wholesome requirement that a final judgment shall be respected even by the court which entered it, and (3) to compel adherence to an orderly process for the disposition of contested issues.

Respectfully submitted,

THE LINCOLN ELECTRIC COMPANY,
By ASHLEY M. VAN DUZER,
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January 3, 1950.

In the Supreme Court of the United States

OCTOBER TERM, 1949.

No. .....

THE LINCOLN ELECTRIC COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

After 30 years of settled construction, the Court of Appeals has given to an important statute a new and disturbing meaning with far-reaching consequences. The court has delegated to revenue agents throughout the land power, withheld by Congress, to say how much, if any, allowance is to be made to a taxpayer for expenses adjudged to be "ordinary and necessary expenses" of a business in computing income subject to tax. Congress has said "All" such expenses "shall be allowed."

OPINIONS BELOW.

The opinions of the courts below may be found:

First Review.

The initial opinion of the Tax Court, three judges dissenting (R. Vol. I, p. 20), holding the payments in question not allowable on any of the three grounds on which they were claimed, and holding it unnecessary, therefore, to pass on the alternative issue whether the payments, if

held to be compensation, were, in the case of 438 out of 979 employees, within the "reasonable allowance" authorized by statute, is reported in **6 T. C. 37.**

The opinion of the Court of Appeals, Judges Simons, Hicks and Allen (R. Vol. IV, p. 107), reversing the Tax Court, and holding the payments constituted "ordinary and necessary expenses," is reported in **162 F. (2d) 379.**

Second Review.

The opinion of the Tax Court, Judge Leech sitting, upon return of the case to the Tax Court, holding that under the reviewing court's opinion and mandate the court was without jurisdiction "to consider further any question as to the reasonableness of the contested payments as compensation," and accordingly overruling the Commissioner's motion to reexamine the payments, has not been officially reported. It has been published in 6 TCM 1218, CCH Dec. 16,136 (M), and in 1947 (P.-H.) T. C. Memo. Dec., Vol. 16, ¶ 47,320. It appears in Record Volume IV, page 47.

The opinion of the Court of Appeals, Judges Miller and Hicks concurring, and Judge Allen dissenting (R. Vol. IV, p. 121), reversing the Tax Court, and holding that the payments, although they are "ordinary and necessary expenses," are nevertheless subject to further inquiry, is reported in **176 F. (2d) 815.**

Petition for rehearing (R. Vol. IV, p. 131) was denied without opinion on October 12, 1949 (R. Vol. IV, p. 143).

JURISDICTION.

Jurisdiction to review exists under §§ 1254(1) and 2101(c) of the Federal Judicial Code. 28 U. S. C. §§ 1254(1) and 2101(c).

STATEMENT OF FACTS.

The essential facts are set forth in the petition.

SPECIFICATION OF ERRORS.

The Court of Appeals erred:

1. In reversing the decision of the Tax Court.
2. In holding payments, held not to be compensation but instead adjudged to be "ordinary and necessary expenses" of carrying on business within the meaning of Internal Revenue Code § 23(a)(1)(A), are subject to the further test of "a reasonable allowance" which the statute in terms confines to "compensation for personal services actually rendered."
3. In qualifying the final judgment entered by the Court of Appeals upon the prior review.
4. In reversing the Tax Court upon a ruling it neither made nor was asked to make.

ARGUMENT.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

The Court should grant the writ prayed for because:

I. CASE RAISES IMPORTANT QUESTION OF CONSTRUCTION OF REVENUE LAW WHICH HAS NOT BEEN BUT SHOULD BE DECIDED BY THIS COURT.

The statute since 1913 has authorized the taxpayer, in computing income subject to tax, to deduct "All the ordinary and necessary expenses" of carrying on business. In the 1918 act Congress added the provision for "a reasonable allowance for salaries or other compensation for personal services actually rendered." Thus the statute now provides, as it has for 30 years, that "there shall be allowed"—

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered" (Internal Revenue Code § 23(a)-(1)(A));

The question is: Are payments which are "ordinary and necessary expenses" of carrying on business—as the court below twice has held, and which it refused to hold are "compensation"—subject to further review by the Commissioner to determine what is "a reasonable allowance" therefor?

The court below thought, although Congress has not said so, and although the statute confines the "reasonable allowance" provision to compensation, that such payments are subject to that further test. This means that every expenditure business makes is henceforth subject, not only to inquiry whether it is in truth what it purports to be, but to further inquiry whether the taxpayer paid too much.

This is a very great power. It is a new step toward a government of men, not law. And it may fairly be doubted whether revenue agents are by any natural aptitude especially qualified to say for a myriad of businesses what amount it is proper for business to lay out upon an expense conceded to be both "ordinary and necessary." In any event, the question, whether the power to do so exists under the statute, is one of large and obvious importance. It is one thing to determine whether a claimed expenditure is in truth an "ordinary and necessary" expense; it is quite another to say how much that expense may be.

The power so to disallow becomes too easily a tool for compelling surrender of otherwise lawful claims on pain of loss of those over which the agent has discretionary power, or for exacting from one what is not exacted from another. The exercise of the power—because in practical operation it must be delegated to many hands—cannot be uniform. And unless Congress compels that result—which itself would seem to raise serious question, for it is only income which may be taxed—a court should not hasten to that result by giving to the statute a new rendering after more than 30 years during which the power has been disowned.

Congress has been content with the reading given the statute in all that period of time. There is no reason, therefore, why a court should write its discontent into law.

The divided court below, however, thought its conclusion, if not compelled, at least directed by three cases to which it referred, two from this Court. These cases have been misread.

If anything, *Botany Worsted Mills v. United States* (1929), 278 U. S. 282, to which the court below referred, casts doubt on the meaning the Court of Appeals has written into the statute. That case dealt with compensation. It arose prior to the time the statute was amended to provide for "a reasonable allowance" for salaries. The Court expressly refused to decide whether the amounts paid could be disallowed (p. 292):

> "merely because, and to the extent that, as compensation, they are unreasonable in amount."

What the Court held was that a payment "in the guise and form of compensation" but having no relation to services performed (p. 293):

> "was not in fact compensation for services, but merely a distribution of a fixed percentage of the net profits that had no relation to the services rendered."

Indeed, even as to compensation, prior to the amendment of the statute to provide for "a reasonable allowance for salaries," it was settled, as the court pointed out in *United States v. Philadelphia Knitting Mills Co.* (3 C. C. A., 1921), 273 Fed. 657, that (p. 658):

> "the Government has no right (until expressly granted by statute) to inquire * * * whether they are too much or too little. But * * * the Government may inquire *whether the amount paid is salary or something else.* * * * It has a right, therefore, to * * * show by evidence, not that a given salary is too much, but that, in the circumstances, the whole or some part of it is not salary at all * * *."

It was primarily from *Commissioner v. Flowers* (1946), 326 U. S. 465, that the court below derived the rule it applied. This Court there pointed out that only "reasonable" traveling expenses can be allowed. The court below misread this to refer to the amount. But this Court in *Flowers* (which held that a lawyer, living in Mississippi and practicing in Alabama, could not deduct the expenses of traveling from the one place to the other, because they were personal expenses) was not talking about amount. The amount was not even in question. The Court, as the context shows, was talking about the *class* or *kind* of expense which is a "reasonable" traveling expense. The Court said (p. 470):

> "The expense must be a reasonable and necessary traveling expense, *as that term is generally understood. This includes such items as* transportation fares and food and lodging expenses incurred while traveling."

The term "reasonable" as there used, obviously had nothing to do with the amount of the expenditure. It had to do with the *class* or *kind* of expenditure. As *Deputy v. du Pont* (1940), 308 U. S. 488, in defining "ordinary and necessary," makes clear (p. 496):

> "It is the *kind* of transaction out of which the obligation arose and its normalcy in the particular business which are crucial and controlling."

Limericks, Inc. v. Commissioner (5 C. C. A., 1948), 165 F. (2d) 483, which the court below also relied upon, dealt with rent. The Tax Court had disallowed the payments, not on the ground that the Commissioner was entitled to say what rent is "reasonable," but on the ground that payments masquerading "under the guise of rent," as the Tax Court found, "were in truth and in fact distributions of dividends" 7 T. C. 1129, 1136. The Fifth Circuit affirmed, pointing out, 165 F. (2d) 483, 484:

> "The Tax Court was not bound to accept the form of this transaction between a corporation and its prin-

cipal stockholder at face value, but was required to make a careful scrutiny to determine how much of the amount, if any, was actually dividends distributed *in the guise* of rent."

There is no general power in the Commissioner to pass on the "reasonableness" in amount of a taxpayer's payments.

The court below has misapplied its authority. It has amended the statute. The decision should be reviewed.

II. DECISION BELOW IS IN CONFLICT WITH DECISIONS OF THIS COURT RELATING TO FINALITY OF JUDGMENTS.

The Court of Appeals upon the first review remanded:

"for further proceedings in accordance with the opinion filed herein" (R. Vol. IV, p. 5).

But this did not prevent the judgment acquiring the status of a final judgment. It made the opinion a part of the mandate. *Gulf Refining Company v. United States* (1925), 269 U. S. 125, 135-6. Therefore, when the court in its opinion adjudged the payments, without qualification of any kind, to be "ordinary and necessary expenses," nothing remained for the Tax Court to do but compute the tax. The judicial process was complete. When both time for review and term expired, that judgment passed forever beyond recall, *Metropolitan Water Company v. Kaw Valley Drainage District* (1912), 223 U. S. 519, 521-4, and this would be true even if the court had been in error, as *Briggs v. Pennsylvania Railroad Co.* (1948), 334 U. S. 304, 306, shows. It was too late, after the statutory time for review had passed and the term had expired, for the court to add qualification of any kind to that judgment.

The court below has exceeded its power.

III. COURT BELOW HAS DEPARTED FROM ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS.

The Court of Appeals has imported a new rule into the law; it has also imported a new issue into this case.

The payments in question were not disallowed on the ground that, if held to be "ordinary and necessary expenses"—as they have been—they were unreasonable in amount. They were so challenged only if held to be compensation—as they have not been—and then only with respect to 438 named employees out of 979. The statutory notice is explicit (R. Vol. III, pp. 612, 613, 635). The trial proceeded on that basis (R. Vol. II, pp. 87-8). The Tax Court noted that "if not of that character [i.e., compensation], no necessity of inquiring as to their reasonableness exists" (R. Vol. I, p. 34). The Court of Appeals upon the first review did nothing to change this (R. Vol. IV, p. 107). Upon the remand the Tax Court was asked to deal with the alternative issue and pass on the amount only "if it is in the nature of compensation" (R. Vol. IV, p. 13). No one suggested there was any such issue in the case as the Court of Appeals has now introduced (R. Vol. IV, pp. 7-43). It was understood that if the payments were "allowable on some ground other than as compensation, the question of reasonableness, as the Commissioner concedes, is no longer here" (R. Vol. IV, p. 17). The Tax Court so understood (R. Vol. IV, p. 47); that is what it ruled upon (R. Vol. IV, p. 49).

The Court of Appeals has decided an issue not in the case.

For the Court of Appeals, after a seven-year litigation has terminated in a final judgment, to reopen the case for litigation afresh upon an issue not raised, is such a departure from the usual and accepted course of judicial proceedings as to call for the exercise by this Court of its revisory power.

CONCLUSION.

The writ should issue.

Respectfully submitted,

ASHLEY M. VAN DUZER,
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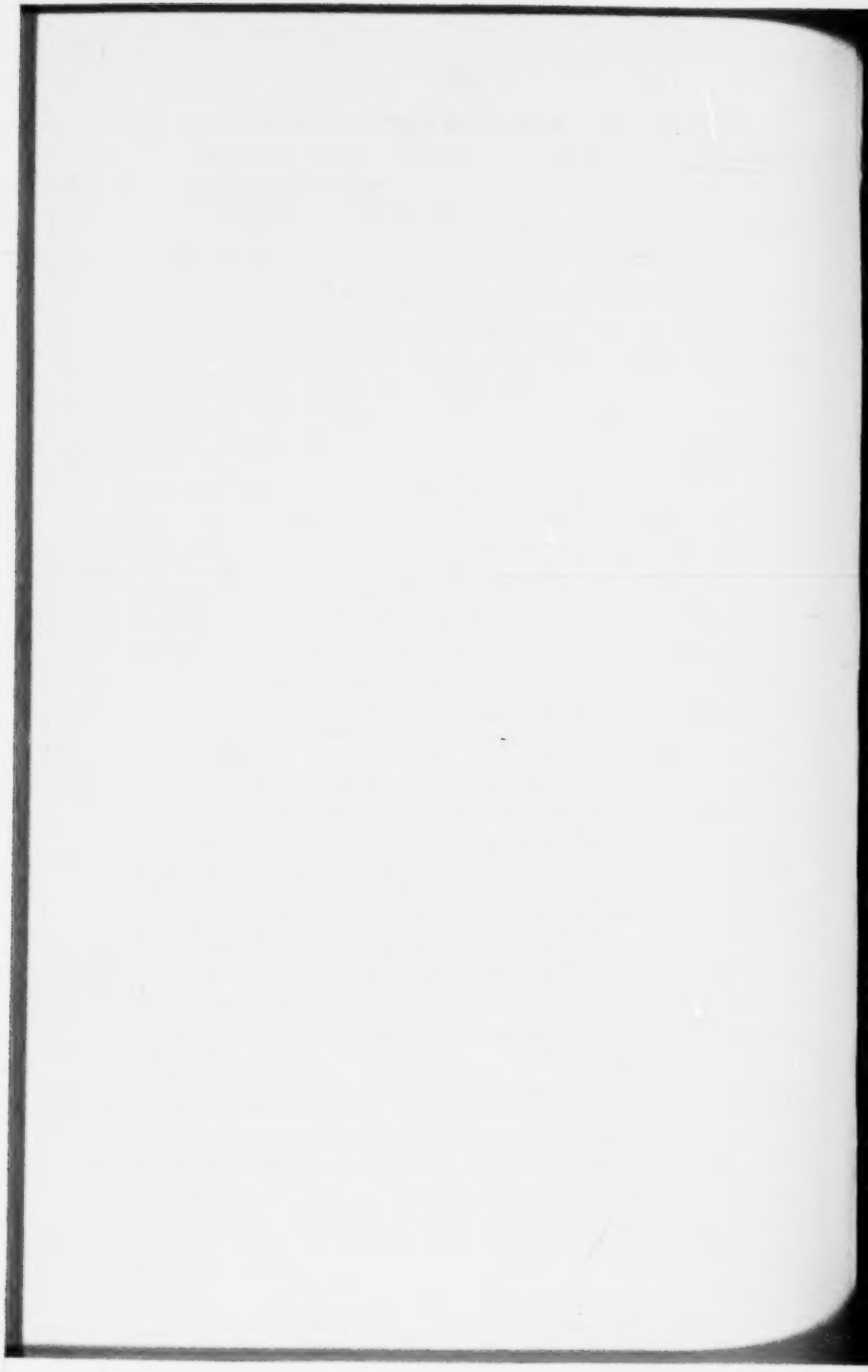
Counsel for Petitioner.

January 3, 1950.



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In the Supreme Court of the United States

OCTOBER TERM, 1949.

No. 533.

THE LINCOLN ELECTRIC COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In view of the assumptions underlying the Commissioner's argument opposing review, it should be noted that there is no question here whether the payments are "ordinary and necessary expenses" of this taxpayer's business. That they *are* "ordinary and necessary expenses" was settled by judgment of the Court of Appeals nearly three years ago. The Commissioner sought no review. By every test that judgment is final and beyond review by any court.[1] And it was reaffirmed upon the second appeal. Said the Court of Appeals:

"On review by this Court, we held that the Tax Court was in error in holding that such payments were not

[1] Although one would not be aware of it from the brief filed here by the Commissioner, the 1940 payment which was originally in question in this case, was allowed by the Commissioner after the first decision of the Court of Appeals. And he did not challenge it upon the second review. Instead, he expressly limited his appeal to 1941 (R. Vol. IV, pp. 83, 88).

ordinary and necessary expenses paid for carrying on taxpayer's trade or business" (R. Vol. IV, p. 122).

In both reviews the court refused to hold the payments constituted compensation. Said the court:

"We * * * reject the Commissioner's * * * contention that although we classified the payments as ordinary and necessary expenses they were also compensatory in nature" (R. Vol. IV, p. 124).

Thus the simple question this case raises is whether payments conceded to be "ordinary and necessary expenses" of a business are deductible in computing income subject to tax.

Congress has given the answer in five lines. It has said deduction "*shall be* allowed" for:

"*All* the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered" (Internal Revenue Code, § 23(a)(1)(A)).

That Congressional command ought to end the case. Clearly, "where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it." *Helvering v. Wood* (1940), 309 U. S. 344, 347; *United States v. Cumberland Public Service Company*, No. 214, October Term 1949, decided January 9, 1950.

And where a court, after 30 years, as here, finds in a statute a new meaning heretofore concealed from all readers, which vitally affects every business filing a tax return, and which, if it be law, gives to the Commissioner a new, vast and terrifying power—which Congress by appropriate language has seen fit to withhold—the case obviously is one which should be reviewed.

The Commissioner hints that if the question is reviewed he will wish to file a cross petition to review other issues, *i.e.*, those decided nearly three years ago in the

first judgment of the Court of Appeals. It is plain that the meaning of the statute here in question can be determined without cross petition by the Commissioner, and moreover, that if filed, it would come too late. *Dickinson v. Petroleum Conversion Corporation,* No. 150, October Term 1949, decided January 16, 1950.

Before a change so vast, in so important a statute, is written into law this Court should examine what has been done.

The writ should issue.

Respectfully submitted,

ASHLEY M. VAN DUZER,
THOMAS V. KOYKKA,
Counsel for Petitioner

January 30, 1950.

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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (I R. 20-47),[1] together with the dissenting opinions (I R. 47-53) are reported at 6 T.C. 37. The opinion of the Court of Appeals, on its first review of the case (IV R. 107-117), is reported at 162 F. 2d 379. The memorandum and order of the Tax Court

[1] The record on certiorari consists of four separate volumes. Record references will be made by indicating the particular volume by a Roman numeral preceding the letter "R."

(IV R. 47-49), entered after the case had been remanded to it, is not officially reported. The opinion of the Court of Appeals reviewing the second decision of the Tax Court (IV R. 121-126), together with the dissenting opinion of Judge Allen (IV R. 127), is reported at 176 F. 2d 815.

JURISDICTION

The judgment of the Court of Appeals was entered on August 29, 1949. (IV, R. 119.) A petition for rehearing was filed on September 17, 1949 (IV R. 129-141), and was denied on October 12, 1949 (IV R. 143). A petition for a writ of certiorari was filed on January 9, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Did the court below err in holding that an expenditure, to the extent that it may exceed a reasonable amount, is not an ordinary and necessary business expense which may be deducted under Section 23 (a)(1)(A) of the Internal Revenue Code?

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing gross income there shall be allowed as deductions:
>
> (a) [As amended by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—
>
> (1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (s), inclusive, and the regulations thereunder. Double deductions are not permitted. * * *

STATEMENT

The facts which are pertinent to the issues which the taxpayer seeks to raise by the petition for a writ

of certiorari may be summarized as follows: During the taxable years 1940 and 1941, the taxpayer expended certain sums, $400,008.84 in 1940, and $575,206.43 in 1941, for the payment of premiums on a group annuity policy. In December, 1941, it also transferred the sum of $1,000,000 to a trust which was created at that time for the benefit of certain employees. (I R. 20-21, 23.) The Commissioner's deficiency determination for 1940 ruled that the amount expended for annuity premiums in that year was not an allowable deduction. (III R. 608-609.) Similarly, for 1941, it was determined, both as to the amount expended for premium payments and the amount transferred to the trust fund, that neither was an allowable deduction under Section 23 of the Internal Revenue Code. (III R. 612-613.) Alternatively, the deficiency determination ruled that, for 1941, if the expenditures should be considered as proper liabilities accrued for salaries and wages and for additional compensation, then, to the extent indicated in a schedule attached to the deficiency notice (III R. 621-635), the premium and trust fund payments were "unreasonable compensation" and not deductible under Section 23 (a) of the Internal Revenue Code (III R. 612-613).

The Tax Court, in its original opinion (I R. 20-47), ruled that no part of the payments in 1940 and 1941 for the annuity premiums and for the creation of the trust fund was deductible, it being held that the payments did not qualify for deduc-

tion as ordinary and necessary business expenses under Section 23 (a)(1)(A) of the Internal Revenue Code. The Tax Court did not pass on the question of the reasonableness of the compensation because, in view of its decision, it considered the question moot. The taxpayer filed a petition for review. (I R. 54.) On review, the Court of Appeals reversed the Tax Court, holding that it had been wrong in concluding that the expenditures were not the type of expenses which the statute considers to be ordinary and necessary. (IV R. 107-117.) The case was remanded to the Tax Court for proceedings in conformity with the mandate. (IV R. 117.) On the remand, further proceedings were held in the Tax Court. It construed the mandate of the Court of Appeals as leaving it without jurisdiction to do anything except to allow the full deduction of all these payments and to compute the tax accordingly. (IV R. 47-49.) The Commissioner filed a petition for review. (IV R. 83-85.) On this petition, the Court of Appeals (Judge Allen dissenting (IV R. 127)) held that the Tax Court had misconstrued the mandate and had erred in failing to consider whether the expenditures exceeded a reasonable amount (IV R. 121-126).

ARGUMENT

1. The decision below, in the respect that it is being complained of by the taxpayer, is correct. The Court of Appeals held that an "ordinary and necessary" business expense is deductible under Section 23 (a)(1)(A) of the Internal Revenue

Code, *supra,* only to the extent that the expenditure is reasonable in amount. Where the expenditure exceeds a reasonable sum, the court decided that the unreasonable portion may not be deducted under the guise of a business expense. The case was remanded to the Tax Court to permit it to make a determination of the factual question whether the expenditures here were reasonable in amount. (IV R. 124-126.)

If it be assumed with the court below that the expenditures in question fall within the general category of expenses if it be assumed further, as did the court below, that the payments were ordinary and necessary in nature, and which are not compensation for services rendered (IV R. 121-124) (assumptions with which we cannot agree),[2] it seems fairly plain that the court correctly applied Section 23 (a)(1)(A) in not permitting the deduction in full of expenditures which might be unreasonable in amount.

The court below stated that (IV R. 124) "* * * the element of reasonableness is inherent in the

[2] The Government contended, successfully in the Tax Court at the first hearing, but unsuccessfully in the Court of Appeals, that these expenditures were not the kind of ordinary and necessary business expenses that are deductible at all under the statute. The Commissioner also asserted, alternatively, that if these were ordinary and necessary expenses, they were intended as compensation for services rendered and were excessive compensation to the extent indicated in the deficiency determination. The Court of Appeals, in its second decision, ruled that the payments were not compensation for services rendered, but nevertheless constituted deductible business expenditures of a non-compensatory nature. The Commissioner believes that the Court of Appeals erred in its rulings in both respects.

phrase 'ordinary and necessary.' " It further observed that Congress never intended "* * * to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount." This is the proper construction of the statute. In *Botany Mills* v. *United States,* 278 U. S. 282, 292, under the Revenue Act of 1916 (even before Congress added to the statute the clause providing for the deduction of a "reasonable" allowance for salaries or other compensation) this Court held that "extraordinary, unusual and extravagant amounts" purportedly paid as compensation, are not in reality payments for services and "cannot be regarded as 'ordinary and necessary expenses' * * *." Thus, while the taxpayer here is contending that there are no limitations under the statute, not even that of reasonableness, on the amounts which a taxpayer may deduct when making expenditures for ordinary and necessary objectives, this Court held to the contrary in the *Botany Mills* case. Further, the decisions of this Court in *Welch* v. *Helvering,* 290 U. S. 111, and *Deputy* v. *duPont,* 308 U. S. 488, with respect to the meaning of the phrase "ordinary and necessary expenses" are inconsistent with any notion that an unreasonable expenditure for any objective could be either "ordinary" or "necessary."

The lower court's construction of the statute is also confirmed by this Court's observation in *Commissioner* v. *Flowers,* 326 U. S. 465, 470, that

to be deductible as an ordinary and necessary business expense, a travelling expense "* * * must be a reasonable and necessary travelling expense, as that term is generally understood." This requirement that the travel expense be reasonable in amount is reiterated in Section 19.23(a)-2, Treasury Regulations 103, and has been stated in all Treasury Regulations, beginning with Article 101 (a), Treasury Regulations 62, promulgated under the Revenue Act of 1921. The statute has thus been long interpreted so that the words "ordinary" and "necessary" incorporate a limitation that the claimed deduction be reasonable in amount. Further, while the rental clause of Section 23 (a)(1)(A), like the travel expense clause, does not contain its own limitations of reasonableness, it has been held that excessive rental payments would not be deductible because such a limitation is contained in the "ordinary and necessary" phrase. *Limericks, Inc.* v. *Commissioner,* 165 F. 2d 483 (C.A. 5th).

The decisions and the administrative construction, accordingly, fully support the decision below in its holding that, if the particular expenditures here should be found by the Tax Court to be unreasonable in amount, they are, to the extent that they exceed a reasonable sum, neither ordinary nor necessary business expenses under Section 23 (a)(1)(A).

While the taxpayer contends that these authorities were misunderstood by the court below

(Br. 25-26), the attempted distinctions all rest on the assertion (Br. 24, 26) that there is a difference between the amount of an expenditure and the "*class* or *kind* of expenditure" involved. The short answer to all this is that such a difference does not exist; an expenditure which exceeds a reasonable amount cannot be classified as an ordinary and necessary business expense, to the extent that it exceeds reasonable limitations.

The taxpayer also complains, at length, that the decision below confers novel and extensive powers on the Commissioner which Congress never granted. (Pet. 12-16, Br. 24, 27.) The court below, contrary to the taxpayer, did not conclude (Pet. 13) that the Commissioner possessed the "power to say which, and how much, if any, of the 'ordinary and necessary expenses' of carrying on a trade or business shall be allowed," nor did the court constitute (Pet. 12-13) "The Commissioner * * * a super-manager for the nation's business." The Commissioner, of course, has the initial duty of determining whether an expense is unreasonable and, consequently, whether it fails to qualify as an ordinary and necessary business expense, just as he must always determine whether any section of the statute has been complied with in every respect. His determinations, however, are always subject to review by the courts in the manner provided for by Congress. If the Commissioner errs in concluding that a part of a particular expenditure is not deductible, his administrative

action is subject to correction by the courts, no matter whether he was wrong with respect to its reasonableness or whether he was wrong in some other respect. It should have been apparent to the taxpayer that the court below did not make the Commissioner a "super-manager" of the nation's business from the very fact that this case was remanded to permit the Tax Court, not the Commissioner, to pass on the reasonableness question.

2. There is no conflict in decisions. The taxpayer does not assert that there are any conflicting decisions on the merits of the controversy, namely, the proper construction of Section 23 (a)(1)(A). Indeed, as we have shown, the decision below follows the decisions of this Court with respect to the meaning of the statute. The taxpayer contends, however, that the decision conflicts with *Metropolitan Co.* v. *Kaw Valley District,* 223 U. S. 519, and *Briggs* v. *Pennsylvania R. Co.,* 334 U. S. 304 (Pet. 16-17; Br. 27), it being contended that the court below, after its first review of the case (Pet. 16) "* * * has reopened, and added qualification to, a prior final judgment of which no review or other correction was sought."

The assertion of this conflict, and the taxpayer's serious charge that the court below (Pet. 17-18; Br. 28) "departed from the accepted and usual course of judicial proceedings," all turn on the unwarranted premise that, after the first re-

view by the Court of Appeals and the issuance of the mandate (Br. 27), "nothing remained for the Tax Court to do but compute the tax." In this the taxpayer is mistaken. The Court of Appeals in its first opinion (IV R. 107-117) did not determine that the taxpayer was automatically entitled to deduct the full amount of these expenditures. The decision was only to the effect that the Tax Court had erred in concluding that these expenses were not the type of payments which were ordinary or necessary and in holding that they were not deductible at all under the statute. Indeed, the opinion on the first review (IV R. 113) made it plain that the question being decided was "whether, as a matter of law, the disallowed deductions constituted ordinary and necessary expenses * * *." That factual matters still remained for the Tax Court was made explicit by the court's express statement that (*ibid.*) "* * * in any event we will not be obliged to determine their reasonableness, for that is concededly within the exclusive province of the Tax Court and it has given no consideration to it * * *."

In view of the court's decision, it is clear that the mandate did not require the Tax Court merely to "compute the tax" on the assumption that the taxpayer was automatically entitled to deduct the *full* amount of the payments. The mandate only compelled the Tax Court to assume, as a matter of law, that the expenditures fell into the class of ordinary and necessary business expenses which

are of a deductible nature. The Tax Court was still required to determine the factual question whether any portion of the expenditures was unreasonable and, to that extent, not an allowable deduction. The first opinion of the Court of Appeals, as we have already observed, expressly stated that this was to be the function of the Tax Court.

The present contention of the taxpayer, it will be noted, was also advanced below and was expressly rejected by the court; the second opinion stated (IV R. 126):

> As a matter of strict interpretation of our ruling, the taxpayer is incorrect in stating that we held the payments to be ordinary and necessary expenses and deductible in full. What was actually decided was that the Tax Court was in error in its interpretation of the law and in its ruling that the payments were not of a deductible character. We so stated in the closing sentences. The ruling of the Tax Court was reversed. The case was remanded to the Tax Court for proceedings in conformity with our opinion. This had the effect of restoring to the Tax Court all the authority that it possessed when the case was first before it, except that it was required to conform to the ruling of the Court. *Swenson* v. *Commissioner,* 69 Fed. (2d) 280, C. A. 5th; *Houston* v. *Commissioner,* 53 Fed. (2d) 445, C. A. 3rd. * * *

Since the taxpayer is wrong in the assumption that nothing except a mathematical computation

of the tax remained for the Tax Court under the first mandate, it is also wrong in its contention that the Court of Appeals lacked authority to correct any errors committed by the Tax Court after the case had been remanded to it; accordingly, the cases relied on by the taxpayer for the asserted conflict are not in point. The contrary is true of the authority of the reviewing court in these circumstances. *Swenson* v. *Commissioner,* 69 F. 2d 280 (C.A. 5th). Indeed, the Court of Appeals would have had authority in its second decision to correct errors which it itself may have committed in its first decision. *White* v. *Higgins,* 116 F. 2d 312, 317 (C.A. 1st). It will be noted that in the present case the Commissioner asserted below that the Court of Appeals had erred in its first decision; the court refused to disturb its prior ruling, not on the ground of lack of jurisdiction, but because it believed its prior ruling to be correct. (IV R. 121-124.) Furthermore, this Court possesses authority to correct errors committed by the court below, even in its first decision. *Hamilton Shoe Co.* v. *Wolf Brothers,* 240 U. S. 251; *Panama Railroad* v. *Napier Shipping Co.,* 166 U. S. 280; *United States* v. *A. S. Kreider Co.,* 313 U. S. 443; *Burnet* v. *Flannery Bolt Co.,* 286 U. S. 524. Accordingly, the authority of the court below to correct errors committed by the Tax Court in the course of its proceedings on the mandate is an *a fortiori* matter.

The taxpayer's further assertion (Pet. 17-18, Br. 23, 28) that the court decided a matter which was not previously in issue, is equally wrong. Since an ordinary and necessary business expense may not exceed reasonable limitations, that issue was implicitly raised at the very outset by the taxpayer's petition to the Tax Court which, in controverting the Commissioner's deficiency determinations, asserted that these expenditures were deductible as ordinary and necessary business expenses. (I R. 4-13.) To succeed, the taxpayer was required to establish all elements necessary to the claimed deduction. *Helvering* v. *Gowran,* 302 U. S. 238; *Irish* v. *Commissioner,* 129 F. 2d 468 (C.A. 3d); *Alexander Sprunt & Son* v. *Commissioner,* 64 F. 2d 424 (C.A. 4th). The taxpayer, accordingly, was not entitled to prevail in the Tax Court in the first instance except by establishing that the expenditures were *of the type* which are ordinary and necessary, and by also establishing that the particular *amounts* paid were ordinary and necessary, that is, that they were reasonable in amount. This issue having been raised by the taxpayer, there was no need for any particular pleadings by the Commissioner to require a decision on the point. *Burton-Sutton Oil Co.* v. *Commissioner,* 161 F. 2d 558 (C.A. 5th).

Even if there had been no specific issue on the question of reasonableness, the Commissioner, having been successful in the first instance in the Tax Court, was entitled to urge any grounds in

the reviewing court to sustain the decision below. *Helvering* v. *Gowran,* 302 U. S. 238; *Hormel* v. *Helvering,* 312 U. S. 552. In defending the Tax Court's decision on the first review in the Court of Appeals, the Commissioner's brief (p. 45) argued that the expenditures were so extraordinary in amount that they could not qualify for deduction as ordinary and necessary business expenses. The issue was thus properly presented to the Court of Appeals. While, because of the lack of appropriate findings on the part of the Tax Court, the Court of Appeals refused to decide this issue as a matter of law, there is no doubt that the issue remained alive when the case was remanded to the Tax Court and that it should have been decided by it pursuant to the mandate. That is the substance of the second decision of the Court of Appeals. (IV R. 121-126.)

It is true that in the proceedings in the Tax Court pursuant to the mandate, the parties were primarily contending over the issue whether the reviewing court's first decision still left open the question whether these were compensatory payments, an issue which the Tax Court (IV R. 47-49) and the Court of Appeals (IV R. 121-124) determined adversely to the Commissioner. However, the Commissioner never waived the over-all issue of reasonableness (cf. *Helvering* v. *Wood,* 309 U. S. 344), and the Court of Appeals was empowered to reverse the Tax Court for implicitly deciding this issue contrary to the correct mean-

ing of the statute (*Helvering* v. *Gowran,* 302 U. S. 238; *Hormel* v. *Helvering,* 312 U. S. 552; *Helvering* v. *Richter,* 312 U. S. 561).

3. The only issue determined against the taxpayer by the court below, namely, whether an expense can be unreasonable in amount and, at the same time, an ordinary and necssary business expense under Section 23 (a)(1)(A), was properly decided. It should be pointed out that this issue is only one aspect of the entire case, and that the case also involves other closely related issues decided against the Commissioner (see fn. 2, *supra,* p. 6) including the question whether the Commissioner and the Tax Court were wrong in determining that no part of these expenditures was deductible at all as ordinary and necessary business expenses. It is clear, accordingly, that if this Court should decide to grant the taxpayer's petition, the case could not be properly reviewed without a consideration of all the elements of the decision below. Since this case does not seem to warrant further review by this Court, no petition for a writ of certiorari will be filed on behalf of the Commissioner to review the aspects of the decision rendered adversely to the Government. However, if the taxpayer's petition should be granted, the Solicitor General intends to file a cross-petition with respect to the matters decided adversely to the Government in order that this Court may have an opportunity to afford a full and complete review of the case.

CONCLUSION

The decision below is correct. No conflict in decisions exists. Further review of this case would not be warranted. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully.

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